

REPORT OF THE AUDITOR-GENERAL TO THE COUNCIL ON THE FINANCIAL STATEMENTS OF THE CITY OF MATLOSANA FOR THE YEAR ENDED 30 JUNE 2006

1. AUDIT ASSIGNMENT

The financial statements as set out on pages ... to ..., for the year ended 30 June 2006, have been audited in terms of section 188 of the Constitution of the Republic of South Africa, 1996, read with sections 4 and 20 of the Public Audit Act, 2004 (Act No. 25 of 2004) and section 126 of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA). These financial statements are the responsibility of the Municipal Manager. My responsibility is to express an opinion on these financial statements, based on the audit.

2. SCOPE

The audit was conducted in accordance with the International Standards on Auditing read with General Notice 1512 of 2006, issued in Government Gazette no. 29326 of 27 October 2006. Those standards require that I plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement.

An audit includes:

- examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements
- assessing the accounting principles used and significant estimates made by management
- evaluating the overall financial statement presentation.

Furthermore, an audit includes an examination, on a test basis, of evidence supporting compliance in all material respects with the relevant laws and regulations which came to my attention and are applicable to financial matters.

I believe that the audit provides a reasonable basis for my opinion.

3. BASIS OF ACCOUNTING

The council's policy is to prepare financial statements on the basis of accounting determined by the National Treasury, as described in note 1 of the accounting policies to the financial statements.

4. QUALIFICATION

4.1 Fixed assets: Infrastructure

I was unable to verify infrastructure assets with a carrying value of R331 857 887 as disclosed in note 9 to the financial statements due to the lack of proper record-keeping and maintenance of the physical assets register as required by GAMAP 17. The municipality's records did not permit the application of any alternative auditing procedures regarding these assets. Consequently I did not obtain all the information and explanations I

considered necessary to satisfy myself as to rights and obligations, completeness and existence of infrastructure assets.

4.2 Long-term receivables

4.2.1 Housing

Notwithstanding timely and repeated requests, the following supporting documentation for long-term receivables of R8 684 736 regarding housing, disclosed in note 10 to the financial statements, could not be presented for audit purposes, resulting in a limitation on the scope of the audit.

- Agreements between the council and long-term debtors
- Monthly reconciliation of long-term receivables
- List of monthly repayments made during the year
- Calculation of short-term portion of long-term receivables
- Interest levied on the long-term receivables
- Long-term receivables written-off during the year under review

4.2.2 Abattoir

Included in long-term receivables disclosed in note 10 of the financial statements, is an amount of R10 280 000 in respect of the sale of the abattoir that was not tested for impairment by management and subsequently not written off, therefore long-term receivables is overstated by this amount.

4.3 Interest paid

Interest paid of R24 679 973 disclosed in the statement of financial performance includes interest and redemption of R6 142 876 paid to the Development Bank of South Africa (DBSA) for which no loan agreement could be submitted for audit. The municipality's records did not permit the application of any alternative auditing procedures regarding these payments nor could third party confirmation be obtained from DBSA. Consequently I did not obtain all the information and explanations I considered necessary to satisfy myself as to the occurrence and accuracy of the payment of R6 142 876.

4.4 Interest earned - external investments

Interest earned of R11 406 244 disclosed in the statement of financial performance is understated with R1 736 765. This is due to previous years' interest accrued on the New Republic Bank investment but incorrectly capitalised against the investment, being incorrectly written back against interest earned in the current year instead of against the appropriation account.

4.5 Funds and reserves

During the audit it was found that the council did not maintain an asset register with adequate information to support the following balances disclosed in the statement of changes in net assets:

- (i) The carrying value of property, plant and equipment of R259 105 583 financed by the Government Grant Reserve and Donations and Public Contribution Reserve as per the

asset register, differs with the corresponding reserves of R271 174 848 as disclosed in the statement of changes in net assets.

(ii) The depreciation value of R904 013 for property, plant and equipment financed by the Capitalisation Reserve as per the asset register differs with the balance of R1 679 036 disclosed as Offsetting of Depreciation in the statement of changes in net assets.

4.6 Accounting presentation of financial statements

Contrary to the basis of accounting as disclosed in note 1 to the financial statements, the impact of the following IAS standards was not addressed in the accounting policies of the council:

(i) IAS 17 - Leases (Straight line basis and non-disclosure of leases).

The disclosure of the lease payments on the remaining period was not disclosed in the notes to the financial statements.

(ii) IAS 32 - Financial instruments (Disclosure and presentation)

Council did not disclose its risk management policies and exposure as well as the impact thereof in the financial statements.

(iii) IAS 39 - Financial instruments (Recognition and measurement)

Financial assets were not properly measured and disclosed according to the subsequent measurement of financial assets. The effect of the incorrect application of accounting standards was impracticable to quantify.

(iv) IAS 40 - Investment property

The market value of investment property was not disclosed in the financial statements.

(v) IAS 41 - Agricultural (Valuation and recognition of livestock)

The value of the game in the nature reserve is incorrectly disclosed as 50% of the current realisable value instead of the realisable value less cost to sell. This resulted in an understatement of approximately R2 643 425.

5. DISCLAIMER OF AUDIT OPINION

Because of the significance of the matters referred to in paragraph 4, I do not express an opinion on the financial statements.

6. EMPHASIS OF MATTER

Without further qualifying the audit opinion expressed above, attention is drawn to the following matters:

6.1 Financial statements: Presentation and disclosure

6.1.1 Confirmation received from SARS indicated a late submission of the VAT return for January 2006. This implies a misrepresentation in note 33 to the financial statements, which states that all VAT returns were submitted by the due date.

6.1.2 Appendix A to the financial statements does not include disclosure of the carrying values of property, plant and equipment acquired by loans.

6.2 Fruitless and wasteful expenditure

Monthly employee tax and VAT returns submitted late to the Receiver of Revenue, resulted in penalties and interest of R76 748 being paid during the year. This fruitless and wasteful expenditure was however not accounted for according to the prescribed framework nor was it disclosed as such in the financial statements.

6.3 Irregular expenditure

Contrary to section 57(4B) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) performance bonuses of R85 447 were paid to employees not directly accountable to the municipal manager during the financial year. This irregular expenditure was however not disclosed as such in the financial statements.

6.4 Provision for leave

According to paragraph 7.5 of the SALGA guideline on Conditions of service of Local Government "any leave in excess of 48 days may be cashed should the employee be unable to take such leave as a result of operational requirements. If, despite, being afforded an opportunity to take leave, an employee fails, refuses or neglects to take the remaining leave due to him during this period, such remaining leave shall fall away." Contrary to the above, it was found that the provision includes instances where more than 48 days credit was provided. The total days overprovided is 942 days, with a monetary value of R365 361.

6.5 Non compliance with laws and regulations

6.5.1 Contrary to schedule 2, paragraph 10 of the Municipal Systems Act, 2000, which requires that a staff member of a municipality may not be in arrears for rates and service charges for longer than 3 months, the arrears of staff members amounted to R886 368. MAYCO resolution 460/2002 dated 20 May 2002 to clear the consumer accounts of officials and council members has thus also not been adhered to.

6.5.2 Contrary to section 45(b) of the Municipal Systems Act, 2000 and sections 126(1) and 126(3) of the MFMA, the performance report was not presented for audit within two months after the financial year-end.

6.5.3 Contrary to section 129(1) of the MFMA, the Council did not consider the annual report for 2004/05 and adopt an oversight report within two months of the annual report being tabled in Council on 31 January 2006. Council only considered the annual report on 22 May 2006.

6.5.4 In terms of an amendment of section 20(4) of the Value Added Tax Act, 1991 (Act no. 89 of 1991) effective from 1 March 2005, the VAT registration numbers of both vendors must be disclosed on invoices exceeding R3 000. During the audit it was found that council's invoices do not meet this requirement, nor are there measures to ensure that invoices of suppliers to council, comply.

6.5.5 In terms of sections 9 and 10 of the Basic Conditions of Employment Act, 1997 (Act No.75 of 1997), officials are limited to regular hours of 45 per week and overtime hours of 10 per week (15 if a collective agreement exists). Contrary to this requirement,

overtime was paid to employees in excess of these limits, in some cases exceeding 30% of their basic salary.

6.6 Internal audit

The following weaknesses identified during the evaluation of the internal audit department, resulted in no reliance being placed on the internal audit function for the purposes of my audit:

- (i) Contrary to section 165(2) of the MFMA, a risk-based audit plan and an internal audit program was not prepared for the financial year.
- (ii) Audit procedures, working papers and internal audit reports did not always comply with the standards of the Institute of Internal Auditors.
- (iii) There were no internal or external quality assurance reviews on the internal audit activities for the financial year under review.
- (iv) An internal audit training and development programme had not been developed to facilitate continuous training of staff.

6.7 Weaknesses in internal control

6.7.1 Inventory of R554 649 (fuel and diesel) was written off by the engineering department at year-end without a council resolution as required by section 29 of the standard financial ordinances of council.

6.7.2 Contrary to the council's Fresh Produce Market Policy, credit sales are allowed to customers without a guarantee. One example in this regard had an outstanding balance of R397 665 as at 30 June 2006 and was handed over to the debt collectors during July 2006. No provision was however made for bad debts in this regard. The recoverability for this debt seems doubtful and if not recovered, should be regarded as fruitless and waste expenditure.

6.6.3 From a sample selected on the expiry of official council vehicle licenses, 50% of the vehicles licenses checked were not renewed timeously.

6.8 Consumer deposits

Consumer deposits of R15 043 324 represent only 21% of the net balance of consumer debtors of R71 035 324 as at 30 June 2006. Furthermore the consumer deposit tariff list of 26 June 2001 was still in use for the 2005/2006 financial year. An updated list was only implemented from 1 October 2006.

6.9 Services

6.9.1 The distribution loss for water as at 30 June 2006 represented 28% of purchases, with a monetary value R17 972 487. This is high considering the accepted norm of 10%.

6.9.2 The distribution loss for electricity as at 30 June 2006 represented 16 % of purchases, with a monetary value of R9 871 029. This is high considering the accepted norm of 10 %.

6.9.3 A follow-up of paragraph 5.2.5(b) of the 2002/2003 audit report and paragraph 5.4.3 of the 2003/2004 audit report, regarding the findings on selected water and electricity

meters at Hartbeesfontein, indicated that the same problems still existed at these meters as at 7 November 2006, which included:

- (i) the water meters were leaking.
- (ii) the electricity meters were not sealed.
- (iii) the water meters were not accessible and/or readable due to leakage.

7. APPRECIATION

The assistance rendered by the staff of the City of Matlosana during the audit is sincerely appreciated.

ND Maphiri *for* Auditor-General

Rustenburg

30/11/2006

